Docket No. R-1314 (Regulation AA)
Meetings at the Federal Reserve Board on October 31, 2008

On October 31, 2008, Leonard Chanin (Associate Director) and James Michaels (Assistant Director) of the Board's Division of Consumer and Community Affairs as well as members of the Division's staff met with the following individuals to discuss the proposed rules under the Federal Trade Commission Act (Regulation AA): Travis Plunkett (Consumer Federation of America); Dr. Larry Ausubel (University of Maryland); Kathleen Keest & Josh Frank (Center for Responsible Lending); Kyle Kempf (National Small Business Association); Ed Mierzwinski (US PIRG); Lauren Saunders (National Consumer Law Center); Linda Sherry (Consumer Action).

The meeting focused on concerns about the credit card data submitted with the August 7 and October 3, 2008 comment letters from Oliver Ireland of Morrison Foerster LLP. Dr. Ausubel stated his belief that this data was based on inaccurate assumptions and overstated the potential effects of the proposed rules. His comments are summarized in the attached document.

The attendees urged the Board to allow repricing for violations of the account terms only when the consumer is 30 days' delinquent (as proposed) and to ensure that any repricing is reasonably proportionate to risk. The attendees also requested that the Board minimize the period between issuance of a final rule and the rule's effective date and prevent extensive repricing during that period. Finally, the attendees urged the Board not to weaken the proposed rules regarding subprime credit cards.

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Sample Calculations by Prof. Lawrence M. Ausubel

Taken from Oct. 3, 2008 submission by MoFo (Exhibit 1, Table 1b, p. 10 of pdf).

(1) MoFo uses a default measure of 90 days past due or bankrupt. This overstates losses by about a factor of 1.4:

First, according to footnote 2 of Aug. 7, 2008 submission by MoFo, only 80% of these accounts "will be charged off or go bankrupt." Second, of those accounts that are charged off or go bankrupt, there should be about a 10% recovery rate. This gives:

$$1 / [\, 0.8 \times (1 - 0.1)] = 1.39 \ .$$

(2) A Calculation based on May-06 cohort.

Account current: 9.3% / (22 months/12) = 5.1% annual rate
Account 16 – 30 days late: 20.7%/ (22 months/12) = 11.3% annual rate
Differential is a 6.2% higher probability per year of 90 days past due or bankrupt.
Adjusting by Part (1), the increased probability per year of default is:

$$(12 / 22) \times (20.7\% - 11.3\%) / 1.39 \ = \ 4.47\%$$

Nevertheless, the standard penalty rate is a 12% to 15% increase in interest rate.

(3) A Calculation based on Apr-07 cohort.

Account current: 4.5% / (11 months/12) = 4.9% annual rate
Account 3+ DPD twice in 12 mo: 11.5%/ (11 months/12) = 12.5% annual rate
Differential is a 7.6% higher probability per year of 90 days past due or bankrupt.
Adjusting by Part (1), the increased probability per year of default is:

$$(12 / 11) \times (11.5\% - 4.5\%) / 1.39 \ = \ 5.5\%$$

Nevertheless, the standard penalty rate is a 12% to 15% increase in interest rate.

(4) Using a better measure for conditioning in the sample would yield still lower estimates of the probability of default. MoFo looks at "account 16 – 30 days late." It would be more relevant to condition on "account 16 – 30 days late *but account becomes current before day 31*." After all, if the cardholder fails to become current before day 31, the lender would still be able to increase the rate under the 30-day rule. Since becoming current is good news, this must imply lower default rates.